# PHILIPPINES ECONOMIC WRAP-UP
# FEBRUARY 3-9, 2001

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**Summary**
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Our somewhat longer report this week, in addition to the usual forex, interest rate and stock market reports, includes an item on how the government intends to operate for the next few months without a new budget. We also report on other economic business the Congress failed to complete before recessing on February 8, including a 2001 budget and a power sector restructuring bill. January inflation accelerated significantly, as firms yielded to cost-push pressures. Accompanying the new administration are a few new investments, including the reopening of the Norkis plant in Cebu (we reported its closure back in our December 8 edition). We note the continued rise in the commercial banking sector's non-performing loan ratio (and the expectation that the trend has not yet peaked). Finally, we report on how the rehabilitation of Urban Bank has been stalled by the miasma of scandals surrounding former President Estrada.

These weekly reviews are available on the Embassy's web site (http://usembassy.state.gov/manila). We provide a longer and more detailed review of the Philippine economy in our October Economic Outlook, which is also available on our web site. The next edition of the Outlook has been revised to reflect recent political developments and should be available next week.

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### FOREX REPORT

The Philippine peso strengthened somewhat against the dollar this week. Traders credited weak corporate demand for dollars as well as increased inflows for equity investments as helping to support the currency. Traders predicted the peso could recover to trade at below P48/US$ by early next week. Overall, the peso ended the week at P48.20/US$, a 1.87% strengthening from its February 2 close of P49.12/US$.

Exchange Rate Tables

| Date | Weighted Average (Pesos/US$) | Closing (Pesos/US$) | Volume (Million US$) |
|---|---|---|---|
| JAN 01 | Markets Closed | | |
| 02 | 51.294 | 51.000 | 84.0 |
| 03 | 51.025 | 51.040 | 128.5 |
| 04 | 50.953 | 50.970 | 126.2 |
| 05 | 51.092 | 51.000 | 145.5 |
| JAN 08 | 50.939 | 50.940 | 93.0 |
| 09 | 50.902 | 50.935 | 77.0 |
| 10 | 51.064 | 51.150 | 112.0 |
| 11 | 51.325 | 51.325 | 149.5 |
| 12 | 51.460 | 51.590 | 99.6 |
| JAN 15 | 51.978 | 52.400 | 134.1 |
| 16 | 52.649 | 52.780 | 158.0 |
| 17 | 54.808 | 54.625 | 70.0 |
| 18 | 55.013 | 54.790 | 118.5 |
| 19 | 53.357 | 47.500 | 101.6 |
| JAN 22 | 48.207 | 49.300 | 188.3 |

| | | | |
|---|---|---|---|
| 23 | 49.750 | 49.200 | 122.2 |
| 24 | 48.473 | 48.350 | 150.0 |
| 25 | 48.638 | 48.840 | 116.0 |
| 26 | 49.321 | 49.720 | 124.3 |
| JAN 29 | 49.676 | 49.480 | 126.0 |
| 30 | 49.412 | 49.600 | 110.6 |
| 31 | 49.221 | 48.975 | 99.4 |
| FEB 01 | 49.150 | 49.160 | 168.0 |
| 02 | 49.215 | 49.120 | 118.0 |
| FEB 05 | 49.161 | 49.110 | 62.5 |
| 06 | 48.857 | 48.610 | 161.0 |
| 07 | 48.706 | 48.580 | 139.1 |
| 08 | 48.284 | 48.250 | 187.5 |
| 09 | 48.052 | 48.200 | 120.6 |

Source: Bankers Association of the Philippines

## CREDIT MARKET REPORT

Led by last week's Bangko Sentral ng Pilipinas (BSP, the central bank) decision to cut overnight rates 50 basis points, interest rates on 91-day T-bills shed 30.2 basis points at the Monday auction to settle at 10.863%. However, investors expressed skepticism about the government's ability to continue to keep rates low as longer-term issues barely moved. The rate on the 182 day bill fell only 0.7 basis points to 12.174% and the 364-day bill rate fell only 0.5 basis points to 12.694%. A full award of P1 billion worth of 91-day bills was made, but with P1.5 billion worth of each bill tendered, the Treasury Bureau only awarded P260 million and P425 million worth of 182-day and 364 day bills respectively. National Treasurer Leonor Briones, presiding over her last auction (newly appointed National Treasurer Sergio Edeza takes up office this week) blamed expectations of higher budget deficits for 2001 for banks' desire to bid rates up. However, at the Tuesday auction of 7-year T-bonds, interest rates on the long-term paper fell 125 basis points to 16%; a full award of P3 billion was made against P4.89 billion in bids.

## Domestic Interest Rates (in percent)

### Treasury Bills

| Auction Date | 91 days | 182 days | 364 days |
|---|---|---|---|
| JAN 02 | 12.883 | rejected | rejected |
| JAN 08 | 12.598 | 13.657 | 14.240 |
| JAN 15 | 12.365 | 13.657 | 14.237 |
| JAN 22 | 11.760 | 12.556 | 13.136 |
| JAN 29 | 11.165 | 12.181 | 12.699 |
| FEB 05 | 10.863 | 12.174 | 12.694 |

Source: Bureau of the Treasury

### Prime Lending Rates of 15 Expanded Commercial Banks

| Date of Survey | Average | Range |
|---|---|---|
| JAN 04 | 17.3220 | 14.50 – 20.00 |
| JAN 11 | 17.1677 | 14.50 – 20.00 |
| JAN 17 | 17.1154 | 14.50 – 21.00 |
| JAN 25 | 16.8757 | 13.50 – 20.00 |
| FEB 01 | 16.4046 | 12.75 – 20.00 |
| FEB 08 | 15.8376 | 12.50 - 19.00 |

Sources: Bangko Sentral ng Pilipinas; Press reports

## STOCK MARKET REPORT

Trading volumes at the Philippine Stock Exchange were down markedly this week; the average daily value of shares traded so far this is P1.367 billion, but this week volumes were barely half that.  Nevertheless, the 33-share Philippine Stock Index (PHISIX) recorded mild gains as investors looked for bargains among blue chips. Brokers, however, suggested that weak earnings expectations for the first quarter were not exciting much interest among investors.  From its February 2 close of 1669.85, the PHISIX crept up 1.54% to close on February 9 at 1695.59.

Philippine Stock Exchange Index (PHISIX) and Value of Shares Traded

| Date | PHISIX Close | Value (Million pesos) |
|---|---|---|
| JAN 01 | Markets Closed | |
| 02 | 1448.49 | 379 |
| 03 | 1450.96 | 216 |
| 04 | 1475.11 | 366 |
| 05 | 1469.08 | 302 |
| JAN 08 | 1494.38 | 522 |
| 09 | 1531.82 | 682 |
| 10 | 1534.15 | 962 |
| 11 | 1515.89 | 609 |
| 12 | 1541.65 | 798 |
| JAN 15 | 1567.93 | 1910 |
| 16 | 1551.79 | 1359 |
| 17 | 1458.63 | 1876 |
| 18 | 1438.21 | 1114 |
| 19 | 1452.93 | 1204 |
| JAN 22 | 1708.06 | 7161 |
| 23 | 1662.30 | 2724 |
| 24 | 1665.43 | 1153 |
| 25 | 1639.18 | 877 |
| 26 | 1708.18 | 6074 |
| JAN 29 | 1686.28 | 1319 |
| 30 | 1668.43 | 728 |
| 31 | 1687.00 | 1159 |
| FEB 01 | 1669.13 | 601 |
| 02 | 1669.58 | 616 |
| FEB 05 | 1652.08 | 352 |
| 06 | 1664.23 | 652 |
| 07 | 1659.25 | 441 |
| 08 | 1683.44 | 764 |
| 09 | 1695.59 | 995 |

Source: Philippine Stock Exchange

## 2000 BUDGET RE-ENACTED, SUPPLEMENTAL BUDGET PLANNED

Reflecting the results of a meeting during the week between officials of the executive and legislative branches, the Philippine Congress adjourned on February 8 without passing a 2001 budget. (Note: In the Philippines, the budget year coincides with the calendar year.) This means that 2000's P629 billion budget (technically already in force in the absence of a new budget authorization) has been automatically "re-enacted". The new administration's fiscal planners had emphasized that the P725 billion budget level for 2001, presented by then President Estrada in July 2000, was unaffordable. Because of time constraints, it also did not reflect any inputs from the new administration.

On the other hand, a re-enacted budget would constrain the new government from implementing new projects and programs during the year -- including those for which official development assistance (ODA) funds have already been committed. Finance and budget department officials told the Embassy that the compromise reached was to enact a "supplemental" budget when the current Congress reconvenes from June 4-7 to wind up its work. Before adjourning, the Philippine Congress had passed a supplemental budget to fund the upcoming congressional and local elections in May.

Fiscal planners also told the Embassy that the government's deficit ceiling for 2001 has been officially set at P145 billion. The inter-agency Development Budget Coordinating Committee (DBCC) is working on the government's detailed revenue and expenditure targets towards keeping the full-year fiscal deficit within that ceiling. President Macapagal-Arroyo's new fiscal team acknowledges that keeping within that goal will require revenue collection improvements, fiscal austerity, and careful fiscal juggling (to avoid compromising the delivery of essential services such as health and education).

## CONGRESSIONAL SESSION ENDS WITH MUCH UNFINSHED BUSINESS

On February 8 the Philippine Congress formally recessed until early June; the recess marks the informal opening of the electoral season with all of the seats in the House of Representatives and half of the seats in the Senate being contested. The elections are scheduled for May 14; current members of Congress will reconvene for a final session in June, and the new Congress will be seated in July. The current session ends with much unfinished business; for example, the Congress was unable to complete a budget for 2001 (see above).

Another major piece of unfinished business is legislation to restructure the electric power sector to create a competitive market for generation, among other things. A bicameral conference committee version of the legislation was unable to garner enough signatures to push it back onto the floors of the House and Senate for final approval. The Embassy understands that the Bicameral version has significant weaknesses that undermine the original intent of the bill. The new administration has pledged to consult with 'civil society' to rework the bill; it is unclear if this means the bill could still be passed in a special session or during the final session of the current Congress in June, or if the legislation will have to be reintroduced by the new congress in July.

Other key pieces of legislation that fell by the wayside include a bill to amend the Central Bank Act, which would have given the Bangko Sentral ng Pilipinas further powers to more effectively regulate the banking sector, and legislation that would shore up the legal framework protecting intellectual property rights. There will be no patent protection for plant varieties and integrated circuits until next session. And a bill that would strengthen enforcement efforts against optical disk piracy and another that would crack down on cable television piracy are both dead.

Also unfinished were ratifications of WTO agreements on financial services and telecommunications that have been kicking around in the Senate since 1998. Supporters of the agreements have not put them to vote out of fear that they don't have the two-thirds majority needed to pass. That is because some senators believe that the agreements would put Philippine financial sector and telecommunications companies out of business. What opponents of the agreements may not realize is that the Philippines has been steadily liberalizing its financial services and telecommunications sectors for some time now, so that the country is already well on its way to meeting its commitments.

However, there was good news for exporters to the Philippines in the last few days of the congressional session, as a bill that promises to make Philippine customs administration WTO-consistent was sent to the President for signature. The bill, which the new President made a last-minute legislative priority because she hopes that it will be a boon to government revenues, is supposed to eliminate customs discretion in determining the value of imports and give customs the right to conduct post-entry audits.

**JANUARY YEAR-ON-YEAR INFLATION ACCELERATES TO 6.9%**
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The government's National Statistics Office (NSO) reported that January 2001's consumer price index (CPI) increased by 0.8% month-on-month, accelerating slightly from December's 0.7% increase. That month-on-month acceleration reflected more pronounced increases in food prices (mainly in Metro Manila), with the housing and repairs index also contributing. Other major indices generally posted slower month-on-month increases than in December: fuel, light and water (0.4% from 1.8%); clothing (0.4% from 0.6%); services (0.4% from 1%); and miscellaneous items (steady at 0.4%). January saw some respite from further fuel-price hikes, with oil firms pressured to reduce pump prices during that month following softer world price levels the month before.

Government officials told the Embassy that a carryover of December spending into the new year combined with supply-side disturbances and higher costs to push up the heavily-weighted food index (which constitutes more than half of the Philippines' consumer basket). Cooler temperatures, as well as damage inflicted by October and November typhoons, adversely affected fish harvests. A clamp down on cheap chicken imports and on imports of beef (an offshoot of a trade dispute over Australia's restrictions on imports of Philippine fruits) also contributed, as did higher prices for "miscellaneous foods" (such as coffee, cooking oil, powdered drinks, and seasonings).

The CPI increased markedly in year-on-year terms (reflecting the effect of a relatively lower 1999 base). The overall CPI recorded a 6.9% year-on-year increase in January 2001 -- compared with December 2000's 6.6% hike and January 2000's 2.6%. All major indices -- except for fuel, light and water (up 12.5%, the same rate in December) -- posted higher year-on-year rates. January 2001's inflation rate marked the highest year-on-year CPI increase registered since May 1999. Manufacturers had indicated over the past several months that they were finding it increasingly difficult to hold off more significant price adjustments as cost-push pressures (i.e., from higher wages, interest rates, transport and utility rates, and a weaker peso) escalated.

The government's current goal for full-year 2001 is for average year-on-year inflation in the 6-7% range. Economic planners and Bangko Sentral officials expect inflation to moderate beginning the second quarter -- aided by a more stable foreign exchange rate, lower domestic interest rates, steadier (if not lower) world oil prices and, mathematically, by a relatively higher second-semester 2000 CPI base.

PHILIPPINE CONSUMER PRICE INFLATION
(IN %)

| | Year-on-Year | Month-on-Month |
|---|---|---|
| Jan 2000 | 2.6 | 0.5 |
| Feb | 3.0 | 0.4 |
| Mar | 3.4 | 0.1 |
| April | 3.7 | 0.2 |
| May | 4.2 | 0.4 |
| Jun | 3.9 | 0.7 |
| Jul | 4.3 | 0.5 |
| Aug | 4.6 | 0.7 |
| Sep | 4.6 | 0.5 |
| Oct | 4.9 | 0.7 |
| Nov | 6.0 | 1.2 |

| | | |
|---|---|---|
| Dec | 6.6 | 0.7 |
| Average Jan-Dec 2000 | 4.4 | |
| Jan 2001 | 6.9 | 0.8 |

Source: National Statistics Office

**INVESTMENTS MATERIALIZE WITH NEW BUSINESS CONFIDENCE**

NORKIS' MOTORCYCLE ASSEMBLY PLANT TO REOPEN. Reflecting the optimism brought about by the new leadership that has surged through the business community the Mandaue (Cebu) Chamber of Commerce and Industry (MCCI) president has asserted that MCCI members have cancelled all calls for civil disobedience, resumed normal operations, and will hold off on layoffs. In particular, Norkis Group of Companies has announced the reopening of the Yamaha motorcycle assembly plant that was closed in December due to rising production costs brought about by a weaker peso. The Cebu business district saw the temporary shutdown of the 40-year old exclusive assembler and distributor of Yamaha motorcycles in the Philippines as one of the more visible effects of the economic and political crisis that swept the country's business sector.

PETRON TO START WORK ON P6 BILLION FACILITY. Publicly-listed Petron Corporation sees more stability in the foreign exchange market, and is optimistic for a healthier 2001 outlook. Despite a reported net loss of P1.1 billion (about $22 million) for 2000, Petron is expected to start construction of a P6-billion ($120 million) isomerization plant and a gasoil hydrotreater early this year. The new refinery units will allow the firm to produce fuels that meet stringent requirements of the Clean Air Act (CAA) that come into force in 2003 and 2004. The CAA required the total phaseout of leaded gasoline from December 2000, and specified a reduction in the sulfur content of automotive diesel to 0.20% and industrial diesel to 0.30% beginning January 2001. Affected by this CAA provisions are the "big three" oil companies with refining facilities (Petron, Shell and Caltex), and about 18 other petroleum importers and distributors. Petron chairman Jose Syjuco has said the facility would go on line by 2003.

Syjuco sees President Macapagal-Arroyo's recently announced decision not to support the creation of the government-owned "National Oil Exchange" (OILEX) as a helpful step to fully realizing the benefits oil market deregulation. The President has said she was instead batting for measures that would improve transparency in fuel pricing. Moreover, establishing an OILEX runs counter to the government's policy of deregulation, liberalization and privatization, the Department of Energy has repeatedly said. And given the government's ballooning budget deficit, the new administration simply cannot afford an OILEX, which, including physical facilities and inventory, would initially cost the government about P17 billion (nearly $340 million).

DIGITEL CROSSING TO LINK THE PHILIPPINES TO 200 CITIES WORLDWIDE. A multibillion dollar submarine cable will link the Philippines to the world and enhance the growth of electronic commerce and other IT-related services in the Philippines by the first half of 2002. Gokongwei-owned Digitel Telecommunications (Digitel) entered into a joint venture with Asia Global Crossing (AGC) and Broadband Infrastructure Group (BI Group) to form a new company. Named Digitel Crossing, the new venture will invest an initial $30 million to lay a fiber optic backhaul network in the Philippines, which will be ready by the first half of 2002, officials from the three companies announced. AGC, a partnership among Global Crossing, Microsoft, and Softbank will build a pan-Asian submarine cable network that will connect the countries in the region to each other and the rest of the world. The BI Group, an investment holding company focused on international telecommunications, will manage installation of the infrastructure, implement the backhaul network, and help develop the Digitel Crossing telehouse, which will service the bandwidth requirements of different carriers. BI Group's Philippine subsidiary expects to employ around 13,000 Filipinos to support the Digitel Crossing project. The local firm Digitel will leverage on its existing network facilities to build the terrestrial network.

Digitel Crossing, which becomes part of the worldwide Global Crossing network, will give the Philippines (and other Asian countries) direct access to more than 200 major cities in 27 countries. It will also connect about 50 buildings in Makati's central business district via fiber optic cable. As Digitel Crossing brings "high speed capacities" to the local telecommunications environment, a company official projects that the improved connectivity of the country to the world will make telecom services rates more competitive, and new businesses such as call centers and software design to grow substantially.

**NOVEMBER 2000'S NON-PERFORMING LOAN RATIO AT 16.23%**
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The non-performing loan (NPL) ratio of the Philippine commercial banking system increased from 15.56% in October to 16.23% in November –- the highest thus far since the Asian crisis. The overall NPL level (up by 1.8% or P4.4 billion month-on-month) inched up for an eleventh consecutive month while the commercial banking system's loan portfolio (including interbank loans) contracted by 2.5% (P40.2 billion). By the end of November 2000, commercial banks' aggregate non-performing loans had risen 32.2% (P62.9 billion) from the end of 1999 -- much faster than the 0.5% (P8 billion) expansion in outstanding loans over that eleven-month period. Net of interbank loans, the NPL ratio in November was estimated at 17.9%.

Restructured loans (without which NPLs would likely be higher) expanded 5.5% (P4.8 billion) month-on-month and, as of November 2000, had expanded more than 66% from its end-1999 level. Foreclosed assets increased 0.8% (P1 billion) from October 2000 and were 22.6% higher than at the end of 1999. As of November, non-performing assets (the sum of NPLs and foreclosed assets) equaled 12.9% of the total assets of the commercial banking system.

Bankers expressed doubts that NPLs had peaked in November, noting that higher interest rates and political uncertainties may have triggered further loan defaults and inhibited loan growth in more recent months. Looking forward, however, Bangko Sentral officials point to more optimistic business and macroeconomic prospects generated by the recent change in political leadership –- which could translate to stronger credit growth and a slowdown in loan defaults as the year progresses.

SELECTED INDICATORS FOR COMMERCIAL BANKING SYSTEM

| | Nov 2000 | Oct 2000 | Nov 1999 |
|---|---|---|---|
| **Amounts (P Billions)** | | | |
| Total Loan Portfolio (TLP) a/ | 1,590.9 | 1,631.1 | 1,552.1 |
| Non-Performing Loans (NPL) | 258.3 | 253.7 | 226.7 |
| Loan Loss Reserves (LLR) | 105.9 | 105.5 | 81.4 |
| Restructured Loans (RL) | 90.5 | 85.8 | 68.6 |
| Foreclosed Assets (FA) | 120.6 | 119.6 | 80.4 |
| Non-Performing Assets (NPA) | 378.8 | 373.3 | 307.1 |
| Total Assets (TA) | 2,936.1 | 2,956.9 | 2,651.7 |
| **Ratios (In %)** | | | |
| NPL/TLP (NPL Ratio) | 16.23 | 15.56 | 14.61 |
| RL/TLP | 5.69 | 5.26 | 4.42 |
| LLR/NPL | 41.01 | 41.59 | 35.90 |
| LLR/TLP | 6.66 | 6.47 | 5.24 |
| FA/TA | 4.11 | 4.04 | 3.03 |
| NPA/TA | 12.90 | 12.63 | 11.58 |

a/ Includes interbank loans

Source: Bangko Sentral ng Pilipinas

## BANK MERGER/REHAB STALLED BY CONTROVERSY

At the end of the week, Bank of Commerce (BOC) issued a statement that the bank remained committed to Urban Bank's rehabilitation but considered it "prudent to proceed only if all legal issues are resolved with finality". Urban Bank (a medium-sized commercial bank) closed in April 2000 after suffering from heavy withdrawals and was placed under the receivership of the Philippine Deposit Insurance Corp. (PDIC). Bank of Commerce eventually won the bid to acquire and rehabilitate Urban Bank and signed a memorandum of agreement with Urban Bank directors in June 2000 for a merger (with BOC as the surviving entity).

Just a few days before the BOC's latest statement, a February 6 letter to the PDIC and Bangko Sentral indicated that BOC was ready to implement the merger and rehabilitation plans as soon as it obtained confirmation from these government agencies. PDIC officials estimated that Urban Bank (under BOC management) would be able to reopen in March. The bank had finally obtained the approval of more than 90% of its depositors and creditors –- a major condition for the rehab/merger to proceed.

Given that BOC's change of heart occurred within a matter of days, Embassy surmises that the latest decision to proceed more slowly may have been in reaction to recent news and developments. During the week, at least two congressmen (who both served as prosecutors in then President Estrada's impeachment trial) claimed that the former Philippine president -- who allegedly had kept accounts in Urban Bank -- was able to withdraw funds just the day before the latter declared a bank holiday. The congressmen also claimed that the Bangko Sentral Provident Fund had pre-terminated a placement with Urban Bank the day before the bank closed. They accused BSP Governor Rafael Buenaventura (an Estrada appointee with a fixed six-year term under the BSP charter) of having used prior knowledge of Urban Bank's impending closure for these parties' undue advantage. In addition, the Congressmen alleged that an interbank loan (involving a government bank) may have been used to fund the former Philippine president's withdrawals from Urban Bank.